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No. 672

In the Supreme Court of the United States

OCTOBER TERM, 1967

VINCENT CHIODO, ETHEL CHIODO, L. J. CUMMINGS, RUSS WALDRON, LAREE M. CHIODO, GENE A. CHIODO, AMOS P. HANSEN, H. V. PECK, DON CHIODO, ERNEST G. EARL, RAYMOND HANSEN, WILLIAM PETERSON, MARY ANN NELSON, and LOUISE HIGGINBOTHAM,

Petitioners,

vs.

GENERAL WATERWORKS CORPORATION, a corporation,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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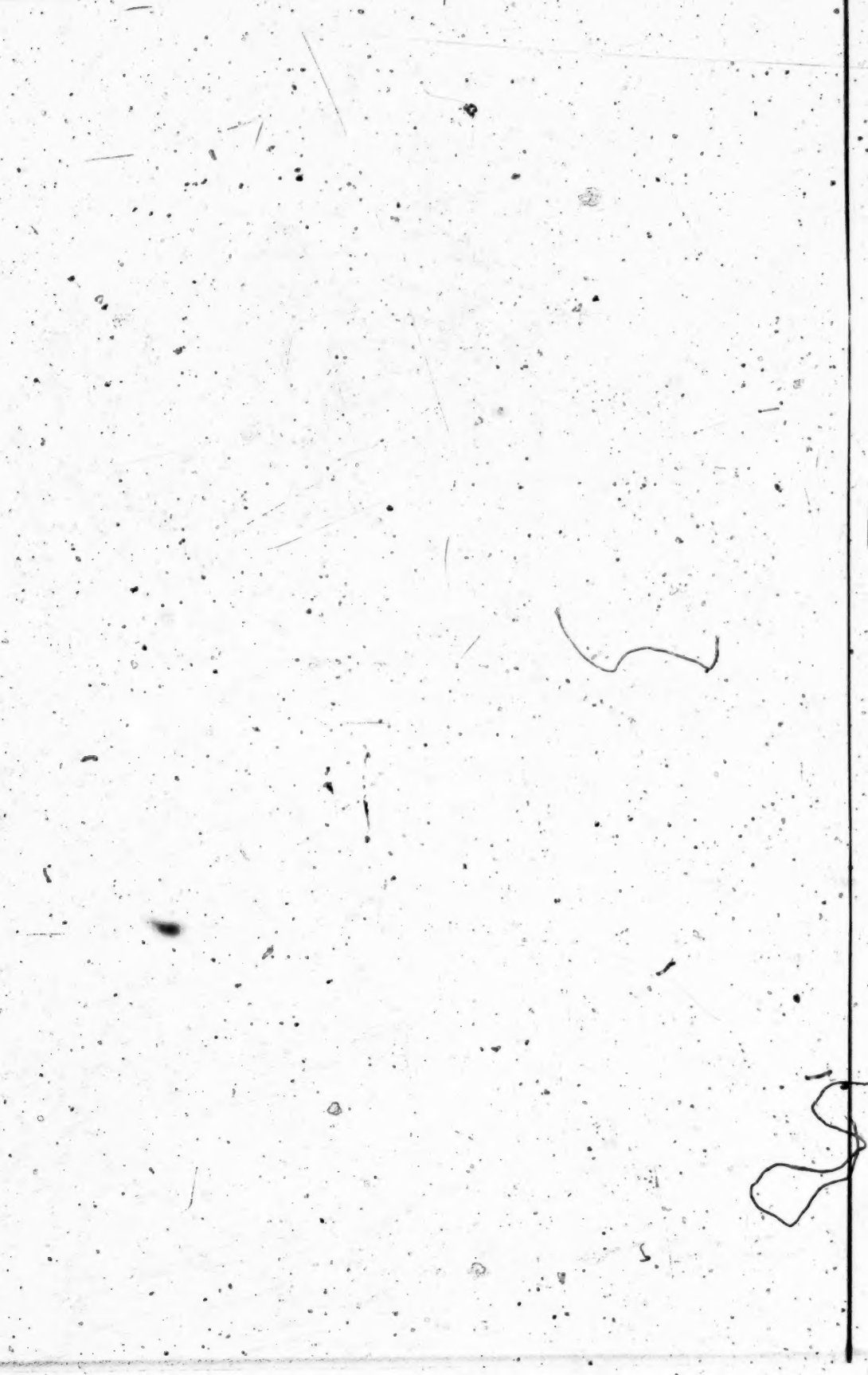

No. _____

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VINCENT CHIODO, ETHEL CHIODO, L. J. CUMMINGS, RUSS WALDRON, LAREE M. CHIODO, GENE A. CHIODO, AMOS P. HANSEN, H. V. PECK, DON CHIODO, ERNEST G. EARL, RAYMOND HANSEN, WILLIAM PETERSON, MARY ANN NELSON, and LOUISE HIGGINBOTHAM,

Petitioners,

vs.

GENERAL WATERWORKS CORPORATION, a corporation,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in the above-entitled case on July 3, 1967.

CITATION TO OPINION BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit which has not yet appeared in the federal

reporter, is included herein as Appendix B. No opinion was published by the District Court.

JURISDICTION

Copy of the Judgment of the United States Court of Appeals for the Tenth Circuit entered in the above case on July 3, 1967 is attached hereto as Appendix A. The jurisdiction of this Court is invoked under the provisions of 28 U. S. C., Section 1254(1).

QUESTIONS PRESENTED

1. Whether the Trial Judge erred in his application of Rule 10b-5 by (a) requiring proof of common law type reliance, (b) requiring proof of common law type causation and (c) restricting reliance to a specific, isolated aspect of an overall scheme, and whether the Court of Appeals compounded these errors by refusing to review them.

2. Whether the Court of Appeals erred in pronouncing a rule that fraudulent misrepresentations in connection with the purchase of securities are not actionable under Rule 10b-5 when made by an "outsider" to an "insider," such as Petitioner Vincent Chiodo.

3. Whether the Court of Appeals erred in pronouncing a rule that the purchase by fraud of securities is not actionable under Rule 10b-5 when the purchase involves substantially all of the voting stock of a "going private business concern."

4. Whether the Court of Appeals erred in holding that the Petitioners did not comply with Rule 51 of the Federal Rules of Civil Procedure or in the alternative, in failing to follow the "plain and obvious error" rule.

5. Whether the Court of Appeals erred in ruling that the statute of limitations barred Petitioners' right to recover and thereby denied them their Constitutional Rights under the Fifth and Seventh Amendments to the Constitution of the United States.

STATUTES, RULES AND CONSTITUTIONAL PROVISION INVOLVED

Section 10(b) of the Securities Exchange Act of 1934 (15 U. S. C. 78j) and Rule 10b-5 promulgated by the United States Securities and Exchange Commission pursuant thereto (17 C. F. R. Sec. 240 10b-5), Rules 49(a) and 51 of the Federal Rules of Civil Procedure and the Fifth and Seventh Amendments of the Constitution of the United States are here pertinent.

15 U. S. C. § 78j: "Manipulative and deceptive devices.

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> "* * *
>
> "(b) To sue or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

17 C. F. R. 240 10b-5: "Rule 10b-5. Employment of Manipulative and Deceptive Devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Rule 49(a) Federal Rules of Civil Procedure: Special Verdicts and Interrogatories.

"(a) Special Verdicts. The Court may require a jury to return only a special verdict in the form of a special written finding upon each issue of fact. * * * As to an issue omitted without such demand the court may make a finding; or, if it fails to do so, it shall be deemed to have made a finding in accord with the judgment on the special verdict."

Rule 51, Federal Rules of Civil Procedure:

"Instructions to Jury: Objection.

"* * * No party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of

his objection. Opportunity shall be given to make the objection out of the hearing of the jury."

STATEMENT OF THE CASE*

The action below was instituted by Petitioners against Respondent to recover damages resulting from violations by Respondent of Section 10(b) of the Securities and Exchange Act of 1934 and of Rule 10b-5 of the Securities and Exchange Commission promulgated pursuant to the provisions thereof.

Prior to December of 1960, Petitioners were the owners of substantially all of the common stock of Bear River Telephone Company (hereinafter referred to as Telephone Company) a small, local public utility rendering telephone service in the Northern part of Box Elder County, Utah. Respondent learned of the existence of that company and of Petitioners' interest therein. Respondent's officers and agents then entered into an overall plan, scheme, device and conspiracy, designed to enable the Respondent to acquire Petitioners' capital stock in the telephone company and hence the control of the company for a fraction of its value, and then to resell the same at an enormous profit.

In order to execute the scheme, certain officers and agents of Respondent concluded that an extensive and extended scheme and course of business including at least three separate misrepresentations of material facts would be required to permit them to achieve the purposes of their illegal venture. The scheme included the representations, repeatedly made, (a) That the sum of $250,000.00 was a

* Summary of the pertinent evidence is attached hereto as Appendix C.

most fair and adequate price for all the telephone company stock owned by Petitioners; (b) That Respondent was not acquiring the [Bear River] Telephone Company stock for purposes of resale, but that it intended to retain the Company as an independent operating unit; and (c) That Petitioner Vincent Chiodo, the largest single shareholder of the telephone company, would be employed for a minimum period of ten years with broad managerial powers and with the assurance that he could continue the employment of his two sons.

Shortly after its successful acquisition of the telephone company stock, Respondent commenced active negotiations for its sale. Although such negotiations for sale or transfer were not immediately successful, they proceeded until an exchange of stock was effected in 1964. At that time, the telephone company stock, acquired by Respondent for a value of approximately $250,000.00, was exchanged for stock of another utility valued at from $3,000,000.00 to $4,000,000.00 or approximately 15 times the amount paid for the stock. Vincent Chiodo was discharged by Respondent on December 6, 1964, and, shortly thereafter, his two sons were likewise discharged by Respondent.

At the trial, the District Judge, over objections of Petitioners, ruled that *reliance* and *causation* of a *common law character* were necessary elements of a cause of action under Rule 10b-5. The Trial Judge further held that the only actionable misrepresentation of the Respondent was the falsification as to *value* and that in determining reliance, the jury would be permitted solely to consider Respondent's misrepresentation as to that one, isolated aspect of the overall scheme. By that limitation, the jury was precluded from considering reliance upon any other false representation or

upon the overall acts and conduct of the Respondent in furtherance of its scheme to defraud the petitioners.

From the initial pleadings to the close of the evidence, Petitioners stressed the overall scheme devised, implemented and executed by the Respondent and Petitioners' reliance on the *totality* of this overall plan. Petitioners stressed that they were influenced by and bottomed their negotiations in significant part upon, Respondent's representations concerning the continued employment and management discretion of the Chiodos and the promise of continued ownership and operation of the company by Respondent as a local business.

At the close of the evidence, the Trial Judge submitted special interrogatories to the jury under Rule 49(a) and charged the members consistent with his holdings set forth above. The form of the proposed interrogatories to the jury were approved by counsel for all parties subject to the understanding specifically reiterated by the Court that approval as to form of the interrogatories could be made without waiving contentions that had been made throughout the trial or foreclosing counsel from excepting to the instructions. Exceptions, which will be discussed below, were duly made by Petitioners to the instructions, following which the Trial Judge again reiterated from the Bench that the approval of the form was without prejudice to Petitioners' basic ideas and contentions.

All parties had requested instructions with respect to the statute of limitations defense interposed by Respondent. However, prior to submission to the jury, the parties stipulated that that issue could be resolved by the Court following the jury's answers to the special interrogatories with

the understanding that the court as a fact finder could resolve any factual problems relating to limitations should the jury's answers to the interrogatories require a finding on that subject. The jury's negative answer to certain interrogatories on reliance negated the necessity of any ruling by the Trial Court on limitations and accordingly the judge entered judgment without reaching or even considering that issue. Following its deliberations, the jury specifically found that Respondent *"knowingly and with intent to deceive"* misrepresented the value of the Telephone Company stock to Petitioners. The Trial Court refused to permit jury consideration of whether Respondent engaged in an overall fraudulent scheme or made other misrepresentations discussed above. By negative response, the jury found that the single misrepresentation as to value, standing alone, did not induce the sale of stock.

The Petitioners appealed to the United States Court of Appeals for the Tenth Circuit to review the rulings of the Trial Court concerning the proper interpretation and application of Rule 10b-5. The Court of Appeals refused to consider the issues dividing the parties at the trial by brushing them aside on the grounds that the action was barred by the statute of limitations and because of an alleged noncompliance by Petitioners with the provisions of Rule 51 of the Federal Rules of Civil Procedure.

REASONS FOR GRANTING THE WRIT

The effective enforcement of federal securities laws will be defeated if the principles announced in this case become the law for the following reasons:

1. The enforcement of federal securities laws by effective civil litigation is in the national public interest and this

purpose will be defeated if the principles announced by the Trial Court and the Court of Appeals in the case at bar are permitted to become law.

2. The holdings of the courts below restricting and limiting the protections of Rule 10b-5 are in conflict with the holdings of the Courts of Appeals for other Circuits in the following particulars:

A. The holding of the Court of Appeals that an expression of untrue opinion will not support a cause of action based upon Rule 10b-5 is contrary to the holding of the Court of Appeals for the First Circuit. See, *Janigan* v. *Taylor*, 344 F. 2d 781 (1965).

B. The holding of the Court of Appeals that a purchase by fraud of substantially all of the capital stock of a corporation is not proscribed by Rule 10b-5 is diametrically opposed to the holding of the Courts of Appeals for the Ninth and Tenth Circuits. See, *Matheson* v. *Armbrust*, 284 F. 2d 670 (1960), *Janigan* v. *Taylor*, *supra*.

C. The holding of the Trial Court that common law reliance and common law causation must be proved as elements of Rule 10b-5 recovery, and which holding the Court of Appeals refused to review, clashes with the Courts of Appeals for the Second and Ninth Circuits and contradicts the earlier holding of the Court of Appeals for the Tenth Circuit. See, *List* v. *Fashion Park, Inc.*, 340 F. 2d 457 (2d Cir. 1964), cert. denied, 382 U. S. 811 (1965); *Ellis* v. *Carter*, 291 F. 2d 270, (9th Cir. 1961); *Stevens* v. *Vowell*, 343 F. 2d 374 (10th Cir. 1965).

3. The holdings of the courts below restricting and limiting the protections of Rule 10b-5 are an open invitation to sophisticated manipulators and repudiate the liberal pur-

poses of the federal securities laws as enunciated by this Court and other Courts of Appeal in the following cases:

A. The strict limitation of recovery to damages resulting from a single, isolated misrepresentation (as distinguished from the entire fraudulent scheme) is not in accord with the holdings of the Courts of Appeals for the Fifth and Ninth Circuits. See, *Hooper* v. *Mountain States Securities Corporation*, 282 F. 2d 195 (5th Cir. 1960); *Errion* v. *Connell*, 236 F. 2d 447 (9th Cir. 1956).

B. The holdings of the lower courts are at variance with the holdings of this court on related securities laws that these statutes should be liberally construed to effect the protection of the public. See, *J. I. Case Company* v. *Borak*, 377 U. S. 426 (1964); *Securities & Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963).

4. Unless the erroneous interpretation and application of Rule 49(a) of the Federal Rules of Civil Procedure by the Court of Appeals is reversed, it will become a pitfall for litigants in Federal Courts. Its application in this case denies Petitioners their Constitutional rights and, if followed, will have the same effect in other cases. Here no finding of fact on the statute of limitations was made by the Trial Court. To fill the void for its purposes, the Court of Appeals substituted itself as a finder of fact and made its own finding on inferences not supported by facts. By so doing, it deprived the Petitioners of the Constitutional rights guaranteed to them by the Fifth and Seventh Amendment to the Constitution of the United States.

5. The interpretation and application of Rule 51 of the Federal Rules of Civil Procedure by the Court of Appeals erodes the very foundation of the Rules as heretofore interpreted and applied by the Courts. In addition, the

principle announced by that Court is at variance with the pronouncements of this Court and with the decisions of other Courts of Appeals. Moreover it is of great public interest, will adversely color and influence subsequent litigation in the Federal Courts, will elevate implied waiver to a preferred position, and, will leave litigants with no standard for determining the form and content of an objection.

The application of the formalistic fiction of waiver in this case is particularly inexcusable in view of the fact that the jury found that Respondent had engaged in an intentional and successful fraudulent scheme. The record is filled with colloquies between the Judge and Counsel, showing a clear understanding of the issues to be decided. These discussions clearly illuminated the contentions of the parties. If the exceptions were formally deficient, an admission Petitioners do not make, the rulings of the District Court were palpably erroneous on their face and the Appellate Court instead of seeking an escape route, should have sought to do justice by applying the clear error rule. Instead of following that course, the Court of Appeals tortured Rule 51 to a point where it was used improperly to legitimize a scheme fraudulently conceived, intentionally practiced and successfully executed.

POINT I.

THE TRIAL JUDGE ERRED IN HIS APPLICATION OF RULE 10b-5 BY (a) REQUIRING PROOF OF COMMON LAW TYPE RELIANCE (b) REQUIRING PROOF OF COMMON LAW TYPE CAUSATION AND (c) RESTRICTING RELIANCE TO A SPECIFIC, ISOLATED AS-

PECT OF AN OVERALL SCHEME, AND THE COURT OF APPEALS COMPOUNDED THESE ERRORS BY REFUSING TO REVIEW THEM.

The egregious errors made by the Court of Appeals are obvious and plain when considered in the light of prior holdings by this Court and the Courts of Appeals of other Circuits. Originally, they arise out of the Trial Judge's imposing evidentiary burdens on to Petitioners which are not required by Rule 10b-5 and the Securities Exchange Act and by limiting the jury to a consideration of a single representation which was part of an overall scheme and device to obtain securities at a price far below actual value.

The courts have consistently construed Rule 10b-5 as imposing civil liability upon persons who violate its proscriptions. One case so holding is *Stevens* v. *Vowell*, 343 F. 2d 374 by the Court of Appeals, Tenth Circuit, (March 16, 1965). In that case, the principal argument advanced by the Appellant was that the District Court lacked jurisdiction over the subject matter for the reason that the evidence failed to establish the elements of the offense. Judge Hill, speaking for the court said:

> "It is, of course, the law that the burden is upon the plaintiff to establish jurisdiction, and coincidentally make out a case under the statute and rule, and to do so he must prove: (1) use of the mails or instrumentalities of interstate commerce; (2) the purchase or sale of a security; and (3) the use of a manipulative or deceptive device. Boone v. Baugh, 8 Cir. 308 F. 2d 711. We shall take these elements up in the order presented.
>
> "* * *
>
> "The third requirement is that there must be the use of a manipulative or deceptive device or contrivance in contravention of such rules and reg-

> ulations as the Commission might prescribe. * * * It is not necessary to allege or prove common law fraud to make out a case under the statute and rule. It is only necessary to prove one of the prohibited actions such as the material misstatement of fact or the omission to state a material fact."

In the case at bar, two of the necessary elements set forth in *Stevens* v. *Vowell* (use of the mails or instrumentalities of interstate commerce and the purchase or sale of a security) were expressly admitted by Respondent (R. 954-74). Hence, in this action, the only element required to be proven is the use of a manipulative or deceptive device. In this regard, the jury specifically found that the defendant "knowingly and with intent to deceive misrepresented in substance and effect that the reasonable value of 2,489.5 shares of the Telephone Company stock was not substantially more than $250,000, and that at the time of such representation * * * such value was substantially more than $250,000" (R. 1140).

This should have ended the controversy, but the Trial Court did not enter judgment for the Petitioners for the reason that it ruled, in contravention of the holding in *Stevens* v. *Vowell*, that two additional elements were necessary. Those elements were specific reliance and proximate cause. Through the theory expressed in the special interrogatories, the Trial Court required the Petitioners to prove that they relied upon Respondent's misrepresentation as to value to such an extent that that misrepresentation operated as a substantial inducement for them to sell their stock to Appellee. In that connection, the Trial Court stated in its instructions with respect to reliance:

> "Plaintiffs may not recover because of any untrue statement of material fact unless they relied

upon such statements. The test of whether they relied is whether the statement was a substantial factor in plaintiffs' decision to sell Bear River Telephone Company at the agreed price. If you find that the plaintiffs relied primarily upon other persons in determining the price for which they would sell their stock and did not place substantial reliance on any untrue statement of material fact relating to value which was made by the defendant, then the plaintiff may not recover, whether or not there was or was not any untrue statements made" (R. 1932).

The Court of Appeals for the Tenth Circuit in *Woodward* v. *Wright*, 266 F. 2d 108 (1959) specifically ruled that reliance was not an indispensable element for recovery under the provisions of Section 12 of the Securities Act of 1933, as amended. Judge Murrah, speaking for the Court, there stated:

> "The trial court's decision is based upon the assumption that the common law duty to prove reliance remains with the buyer. Congress intended, however, to 'throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance', see H. R. Rep. No. 85, 73rd Cong., First Sess. 9-10; and it did not impose the burden of proving reliance on the false statement as a condition of recovery. Having explicitly prescribed the conditions for recovery in recission or damages, we cannot read other common law requirements into the 'special right'. *To say that purchaser reliance is a prerequisite to seller liability is to import something into the statute that is not there.* See 'Securities Regulations' by Loss, supra, 966, 999." (Emphasis added.)

Similarly, in the case at bar, the ruling of the Trial Court that specific reliance is a prerequisite to liability does indeed import something into the statute and the reg-

ulation here involved which is not there. Although the Court of Appeals in *Woodward* v. *Wright, supra,* was construing a different statute, it is submitted that the holding is pertinent because the statute involved was a companion securities statute and because of the similarity of the language involved.

Stevens v. *Vowell, supra,* should have controlled the theories used by the Trial Judge but in spite of his holding that it was not necessary for a plaintiff to allege or prove common law fraud to make out a case under the statute and rule, he imposed upon Petitioners one of the most heavy burdens facing a plaintiff in a fraud action at common law. The instructions and interrogatories submitted by the Trial Judge required Petitioners to not only prove scienter, but also to show reliance and causation. The jury found scienter but because of the negative finding on the interrogatories relating to reliance and causation, the Trial Court entered judgment in favor of Respondent. Significantly, however, the Court made no findings of fact or conclusions of law.

The stringent requirements imposed on Respondents by the Trial Judge are at variance with the rule stated by Professor Loss in his treatise on securities. In treating with the situation where the defendant is a purchaser of stock from the plaintiff, Loss states that, in such circumstances, the plaintiff need not prove reliance, causation, or scienter. In this regard, he concludes:

> "[The 10b-5 seller] is apparently relieved of the burden of proving reliance as in common law recission, not to mention causation, damage and scienter as in common law deceit and at the same time he seems to be faced with no substitute burdens or

defenses." (Loss, *Securities Regulation* (1961), Vol. III, P. 1780.)

This relaxation of the strict requirements of the common law is supported by the language of the Securities Exchange Act. The broad congressional purpose to insure honesty in transactions encompassed within that Act is stated in the enacting clause as follows:

> "AN ACT to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, *to prevent inequitable and unfair practices on such* exchanges and *markets*, and for other purposes." C. 404, Sec. 1, 48 Stat. 881. (Emphasis added.)

And in Section 2, which states:

> "For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related hereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, *and to insure the maintenance of fair and honest markets in such transactions*: . . ." 15 U. S. C. Section 78b. (Emphasis added.)

The United States Court of Appeals for the Ninth Circuit in *Fratt* v. *Robinson, et al.*, 203 F. 2d 627 (1953) discussed the intent of Congress as embodied within the applicable statute and rule. The Court there, in holding that

a complaint grounded upon Section 10(b) of the Securities Exchange Act of 1934 and the Securities Exchange Commission's Rule 10b-5 promulgated pursuant thereto stated a cause of action, summarized the congressional purpose as follows:

> "We think the whole tenor of the act indicates that its operative procedure is by regulation of security-transfer businesses and persons who function in or through them * * *. We think the authors of the act realize that the remedy of the abuses sought to be applied by the act would be more or less completely effective in the proportion of security-trading done on or through the established businesses. To this end Section 10 was enacted in order that those who desire to promote crooked deals would see little advantage in using devious methods to by-pass the security-dealing business houses under regulation. And, further, that prospective crooked deals would be under a powerful deterrent by reason of the fact that perpetrators of fraud and security exchanges would be in violation of Federal laws and, as we shall see in our discussion under the next point to be considered herein, would be answerable in damages in Federal courts to those they have injured."

Petitioners respectfully submit that the action of the Trial Court below flew directly into the face of such congressional intent. In that connection, we point out that the record shows the Respondent and its agents were extremely knowledgeable in securities matters. Its president was the senior partner in one of the nation's large securities houses. During the period involved Respondent had over 100 subsidiaries. Its agents devised a scheme to acquire the Bear River stock of the Petitioners intentionally avoiding the use of a regulated exchange and securities registration requirements. As was found by the jury, the Respondent

planned and executed a crooked deal through the use of devious methods and it well knew it was defrauding the Petitioner. Yet the Trial Court frustrated the purposes of the Act by allowing the admitted violator to escape a powerful deterrent in the form of damages with consequent substantial enrichment to itself by imposing upon Petitioners an unconscionable burden of establishing primary reliance upon one straw in a haystack erected by Respondent.

An additional error of the Trial Court and one preserved by Petitioners on appeal arose out of an instruction that they could not recover unless the false statements of value made by Respondent proximately caused the damages. Counsel for Petitioners could find no other case supporting such a requirement and when faced with this additional burden, they requested an orthodox definition of proximate cause. The Trial Court refused to give any definitive instruction, thus compounding the prejudicial nature of the error by implying to the jury that it must search out and find a single, primary, paramount and controlling cause.

Assuming, arguendo, that the jury should have been instructed on proximate cause, the proper rule was set out in Petitioners' request which should have been given to guide the jury (R. 1080). That requested instruction was refused. It is stated by Mathes & Devitt in their work *Federal Jury Practice & Instruction* (1965) at page 412 as follows:

> "Proximate cause does not mean that the law recognizes only one proximate cause of an injury or damage, consisting of only one factor or thing or the conduct of only one person. On the contrary, many factors or things, or the conduct of two or more persons, may operate at the same time, either independently or together to cause injury or damage;

and in such case, each may be a proximate cause. (Citing Greene, Rationale of Proximate Cause (1927); Prosser, Torts, Sec. 47-50 (2d Edition 1955), 2 Harper & James, Torts, Sec. 20.1-20.6 (1956); Restatement, Torts, Sec. 430-461 (1934)."

Closely associated and blending in with the previously argued error by the Trial Judge is one arising out of the restriction he imposed on the jury in connection with the representations which could be considered in making its findings.

Rule 10b-5 has been quoted hereinabove and is, therefore, not repeated. It obviously proscribes three separate types of conduct in three separately designated paragraphs. In *Troutman* v. *United States*, 100 F. 2d 628 (1938), the Court of Appeals for the Tenth Circuit specifically held that the near-verbatim language of Section 17 of the 1933 Act (15 U. S. C. Sec. 77q) embraces in the disjunctive three separate and distinct acts of a crime.

In the case at bar the Trial Judge erroneously restricted Appellants to recovery under sub-paragraph (2) and then, only as to statements concerning value. In this regard, he instructed as follows (R. 1933-4):

> "In determining reliance, in determining whether there was a false representation made, you are instructed that the only representation in this case which you can consider in determining whether or not plaintiffs have sustained their burden of proof are those which went to the fair value of Bear River Telephone Company stock. You may not consider as evidence of a violation of the rule any evidence pertaining to the stock of General Waterworks Corporation because the evidence indicates that General Waterworks Corporation, without dispute, was sold for what it was represented to be, by Chiodo."

"Nor about Vincent Chiodo's employment contract or the alleged representation that General Waterworks Corporation was buying Bear River Telephone Company for investment purposes, and not for resale, for the reason that those representations, not going directly to value, are immaterial and have no legal consequence, except to the extent, if any, that the circumstances in connection with them may throw light upon the good faith of the defendant, and the relationship of the parties as affecting the question of value, which is the question which we are concerned with in this litigation."

In this instruction the Trial Judge summarized the three principal conditions imposed by the Petitioners upon a sale of their Telephone Company stock, and then specifically prohibited any consideration whatsoever of two of those conditions. Thus the jury was not permitted to determine whether or not representations as to these two conditions were true or false; nor was it permitted to determine whether or not Petitioner relied thereon. This error did not prejudice Petitioners with respect to the representations as to value because, as heretofore noted, the jury expressly found in response to an interrogatory that Respondent did knowingly and with intent to deceive make such misrepresentations. However, the trial court's error in refusing to permit the jury to consider other misrepresentations assumes critical and controlling importance in the light of the instructional requirement on reliance. This, for the reason that the jury was precluded from bundling all the misrepresentations together and determining whether Petitioners were influenced by the bundle of untruths. This is the instruction submitted:

"Do you find by a preponderance of the evidence that the plaintiff Vincent Chiodo relied upon said representation as to value, to such an extent

that such misrepresentation operated as a substantial inducement for him to agree to sell said stock to the defendant."

The evidence was sufficient to support a finding that Petitioners relied upon all the acts and misrepresentations of Respondent which were made in furtherance and execution of its scheme to acquire the stock of the Petitioners and not just on the statements as to value. The representations relating to the employment contract for Vincent Chiodo and his sons and their continued managerial authority and the representations that the Telephone Company was being acquired as an operating facility and not for speculation or resale were factors materially and significantly influencing and inducing Petitioners to sell their stock. At the very least they were material elements which shoulld not have been masked from the jury.

The *Restatement of Torts*, Section 538(2) defines a material fact as follows:

"(2) A fact is material if

"(a) its existence or nonexistence is a matter to which a reasonable man would attach importance in determining his course of action in the transaction in question, or

"(b) the maker of the representation knows that its recipient is likely to regard the fact as important although a reasonable man would not so regard it."

Accord: Loss, *Securities Regulation*, 2d Ed. (1961), Vol. III, P. 1431, et seq.

In addition to those misstatements previously mentioned, the record demonstrates numerous other misrepresentations of a material nature upon which the jury might

have found Appellants reasonably relied. Without burdening this brief with a reference to them, counsel can state that many misstatements and omissions chargeable to Respondent were material within the language stated above.

POINT II.

THE COURT OF APPEALS ERRED IN PRONOUNCING THE RULE THAT FRAUDULENT MISREPRESENTATIONS IN CONNECTION WITH THE PURCHASE OF SECURITIES ARE NOT ACTIONABLE UNDER RULE 10b-5 WHEN MADE BY AN "OUTSIDER" TO AN "INSIDER" SUCH AS PETITIONER VINCENT CHIODO.

Rule 10b-5 previously quoted applies to the purchase and sale of any security to any person. Despite this broad coverage, the Court of Appeals held that Petitioner Vincent Chiodo was not protected first because he was an insider and could not be misled or defrauded and that, insofar as he was concerned, Respondent's misrepresentations were mere expressions of opinion. This is the rationale of the Court:

> "Insofar as the first alleged act of fraud is concerned, little discussion is necessary. Vincent Chiodo, because of his close connection with the Bear River Company for a period of many years was in a better position than any other person to know the true value or worth of that property. It is difficult for us to see how any outsider even if he is possessed with knowledge of the company and its assets could mislead Chiodo about the worth of the company. Any such statement by an outsider to Chiodo could not rise to the height of a false representation, it could be nothing more than an ex-

pression of opinion. In any event, Chiodo had the opportunity to have full knowledge of the true value of Bear River stock and was in the best of positions for more than three years prior to the bringing of this suit to ascertain whether any statements made to him by another about Bear River were false." (Appendix B.)

It is significant that the Court of Appeals cites no authority, and none can be found, in support of this further and substantial limitation of Rule 10b-5. In addition to deviation from the express language of the Rule, this holding ignores completely the evidence demonstrating that Petitioners did not know the true value of the Telephone Company *stock*, but that Respondent's responsible officers did. It further ignores the specific finding of the jury that Respondent "knowingly and with intent to deceive" misrepresented the value of the securities involved.

The Court's suggestion that a mere expression of opinion could not rise to the height of a false representation is contrary to holdings of the Courts of Appeal for the First and Second Circuits. In *Janigan* v. *Taylor*, 344 F. 2d 781 (1955), recovery was permitted under Rule 10b-5 where it was found that the defendant had stated a false opinion. Judge Learned Hand, in interpreting the anti-fraud provisions of the Securities Act of 1933, *United States* v. *Grayson*, 166 F. 2d 863, (2nd Cir. 1948), stated the rule here applicable as follows:

> "As we understand it, Grayson's objection is not that the prosecution failed to prove what it set out to prove, but that opinions, promises, or representations as to the future will not support a charge of fraud. We have repeatedly held the opposite. Indeed it has been the law ever since 1896 (citing *Durland* v. *United States*, 161 U. S. 306, 16 S. Ct.

500, 40 L. Ed. 709) that to promise what one does not mean to perform, or to declare an opinion as to future events which one does not hold, is a fraud."

In *Durland* v. *United States*, 161 U. S. 306, 16 S. Ct. 508, 40 L. Ed. 709, Mr. Justice Brewer speaking for this Court said:

> "The question thus presented is one of vital importance, and underlies both cases. We cannot agree with counsel. The statute is broader than is claimed. Its letter shows this: 'Any scheme or artifice to defraud.' Some schemes may be promoted through mere representations and promises as to the future, yet are none the less schemes and artifices to defraud. Punishment because of the fraudulent purpose is no new thing. As said by Mr. Justice Brown in Evans v. United States (No. 1), 153 U. S. 584, 592 [38: 830, 833]: 'If a person buys goods on credit in good faith, knowing that he is unable to pay for them at the time, but believing that he will be able to pay for them at the maturity of the bill, he is guilty of no offense even if he be disappointed in making such payment. But if he purchases them, knowing that he will not be able to pay for them, and with an intent to cheat the vendor, this is a plain fraud, and made punishable as such by statutes in many of the states'."

In addition to being in conflict with the principles announced in the cases cited above, this holding of the Court of Appeals is erroneous even under the doctrines of common law fraud which do recognize actionability of intentional misstatements of opinion. See A. L. I. Restatement of Law, Torts, Section 539.

POINT III.

THE COURT OF APPEALS ERRED IN PRONOUNCING A RULE THAT THE PURCHASE

BY FRAUD OF SECURITIES IS NOT ACTIONABLE UNDER RULE 10b-5 WHEN THE PURCHASE INVOLVES SUBSTANTIALLY ALL OF THE VOTING STOCK OF A "GOING PRIVATE BUSINESS CONCERN."

This question points up another basic fault undercutting the opinion of the Court of Appeals and its final disposition of the case. Certainly, by considering erroneous concepts, the Court led itself into the wrong result. Apparently it preferred to support the judgment of the trial court by overlooking the fundamental issue of fault with its concommitant damage. The Court of Appeals commenced its discussion of the issues by this prelude:

> "Our first difficulty with this appeal is the sufficiency of proof to make a case. At the outset, all of the facts concerning the transaction between appellants and appellee leave us with grave doubts as to the applicability of Section 10b-5. This was something more than a corporate stock transaction, it was actually the sale of a business and the method used to convey control of the business was suggested by appellants because they derived a tax advantage therefrom and a fixed future income During the period of time the negotiations between the parties were in progress and when the alleged false representations were made, the parties were not negotiating for the sale of corporate stock but rather for the purchase and sale of a going private business concern We have doubt that either the Congress in enacting the Securities Exchange Act or the Securities Exchange Commission in promulgating Rule 24010b-5 had any intention to include a business transaction such as we have here However, we will not pursue this reasoning because there are other clear reasons why appellants cannot prevail."

It is unfortunate that the Court swung away from the important question, for, in the final analysis, had the Court concluded that Congress had intended to cover transactions such as this, the case would in all probability have been decided on its merits rather than being brushed aside by reliance on doubtful procedural questions.

As previously mentioned, the Congressional purpose, as set forth in the Securities Exchange Act of 1934 and as reflected by Rule 10b-5, was to liberalize, not confine, the doctrine of common law fraud. The views expressed by the Court of Appeals in this case obviously do not comport with this stated purpose or with decisions of this Court. Although this Court has not ruled specifically upon the scope of Rule 10b-5, it has made clear that a liberal interpretation is to be accorded all federal securities laws in order to effect their remedial purposes. Thus, this Court said in *Securities & Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 11 L. Ed. 2d 237, 84 S. Ct. 275 (1963) reversing 306 F. 2d 606 (2nd Cir. 1962):

> "Congress intended the Investment Adviser's Act of 1940 to be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes." (p. 195.)

And quoting from *Moore* v. *Crawford*, 130 U. S. 122, 32 L. Ed. 878, 9 S. Ct. 447 (1889):

> "Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another." (p. 194.)

In *J. I. Case Company* v. *Borak*, 377 U. S. 426, 12 L. Ed. 2d 423, 84 S. Ct. 155 (June 8, 1964) affirming the Seventh Circuit Court of Appeals, 317 F. 2d 838, this Court said, (at page 433) :

> "It is for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded. 'And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' *Bell* v. *Hood*, 327 U. S. 673, 684 (1946). Section 27 grants the District Court jurisdiction 'of all suits in equity or actions at law brought to enforce any liability or duty created by this title . . .' In passing on almost identical language found in the Securities Act of 1933, the Court found the words entirely sufficient to fashion a remedy to rescind a fraudulent sale, secure restitution and even to enforce the right to restitution against a third party holding assets of the vendor. *Deckert* v. *Independent Shares Corporation*, 311 U. S. 282 (1940)."

It thus appears that in the *Borak* case, this Court encouraged the lower Federal Courts to be alert to provide necessary remedies to prevent the invasion of federally secured rights. To accomplish this purpose, Rule 10b-5 must be liberally construed. Otherwise, manipulators, such as Respondent here, may, with complete impunity, enrich themselves through knowing and intentional deceits at the expense of the unsuspecting public and in circumvention of congressional intent.

The tragic effect of enforcing the concept suggested by the Court of Appeals is apparent. Such a principle would carve out of the ambit of Rule 10b-5 the more grandiose of fraudulent schemes and permit promoters to take advantage

of the small business owners by acquiring sufficient stock through their clandestine activities to give them complete control of the business. It is respectfully submitted that no case, rule, reason or justification can be marshalled in aid of such an interpretation of Rule 10b-5. Under such a construction, only the marginal promoter need concern himself with the Rule. The rule announced by the Court of Appeals would permit handsome profits to the manipulator with sufficient funds to purchase large blocks of stock and penalize only the less well-healed operator.

If citations are necessary, this holding is directly contrary to the holdings of the Court of Appeals for the Ninth Circuit and the Court of Appeals for the First Circuit. In *Matheson* v. *Armbrust*, 284 F. 2d 670 (9th Cir. 1960), cert. den. 364 U. S. 870, 81 S. Ct. 905 (1961, the Court permitted recovery under Rule 10b-5 where all of the capital stock of the corporation was involved in the questioned transaction. Likewise, in *Janigan* v. *Taylor, supra*, the Court allowed recovery under Rule 10b-5 where "virtually all of the outstanding stock of the company" was involved.

POINT IV.

THE COURT OF APPEALS ERRED IN HOLDING THAT THE PETITIONERS DID NOT COMPLY WITH RULE 51 OF THE FEDERAL RULES OF CIVIL PROCEDURE OR IN THE ALTERNATIVE, IN FAILING TO FOLLOW THE "PLAIN AND OBVIOUS ERROR" RULE.

Prior to the in-chambers discussion concerning the nature and form of the instructions, the Trial Judge had erroneously ruled that proof of common law reliance was required and that such reliance must relate to a single des-

ignated misrepresentation and not to other false statements or to a plan or scheme involving many falsities. This ruling turned Rule 10b-5 from a shield for the unwary to a sword for the manipulator. Tht Court of Appeals, in turn, chose not to review this ruling by utilizing the simple expedient of blaming counsel for not properly preserving the error..

A reading of the footnote made part of the Court's opinion of the Court of Appeals (Appendix B) will reflect that there were references to prior discussions concerning instructions and that everybody at the trial level, including the Trial Judge, well knew the issues involved and the contentions of the parties. In his discussions about the proposed instruction at that time, the Trial Judge was more concerned with form than substance. He was advised by counsel on their theories of the case. In that situation it is indeed a sad commentary on Appellate practice that to avoid answering a question involving a critical issue which was developd fully at the trial level, it is glossed over by seizing on an alleged failure to except to an instruction with the precision of language deemed sufficient by an appellate court. If the holding of the Circuit Court is affirmed on the principle it announced, the result will be that the cooperation of counsel on the form of instructions or interrogatories will be converted into a waiver involving substantive questions of law which were consistently maintained throughout the proceedings and expressly understood and fully considered by the Trial Judge.

Petitioners will not take the time of this Court in this Petition to recite all pre-trial and trial incidents which raised their theories of the case. Suffice to say that after having rejected Petitioners' contentions, as a matter of law, the Trial Judge requested that counsel consent to the

form of the instructions with the express understanding that such approval could be given without waiving any contentions that had been made throughout the trial or foreclosing counsel from preserving their basic ideas.

Two examples only will be used to point out that the Trial Judge was informed on all facets of the controversy and understand the exception. In connection with the admissibility of certain documents showing that Respondent had misrepresented the employment of Vincent Chiodo, counsel for Petitioners stated:

> "Our position is that this is a part of the overall scheme. They saw the property, they wanted to get it, they after talking to Chiodo knew that they had to make certain representations to him to get it, and this is one of them; and we think this is relevant to show they never intended any part of this thing at the time they were negotiating. They go to all odds to promise what they had to promise to get their hands on it."

In regards to the form and sufficiency of the exception taken, counsel submit that they were entirely adequate within the meaning of Rule 51. The Court had instructed the jury as follows:

> "There was no violation of the statute and rule unless you find by a preponderance of the evidence that untrue statements of material facts relating to value were made."

At least one pertinent exception was taken to the instruction and it is as follows:

> "Mr. Duncan: We asked about that this morning. And for the record — and its difficult to identify by number — but the instructions with respect to proximately causing, without explaining that there may be several proximate causes. As to re-

liance, which I think was about 9, that the — the word 'primarily' as we noted this morning, we felt was objectionable.

"The Court: Yes, you did note that this morning.

"Mr. Duncan: And the item — Instruction No. 4, I think of defendants, the Court gave in substance. And it related to the only fact you may consider error.

"We feel this was unduly restrictive and possibly —

"The Court: I see."

The Court below fully understood that, through this exception, Petitioners were challenging his instruction limiting the jury to consideration of the only fact that he submitted for consideration. It is manifest from the response he made, i.e "I see" that there was no question about the subject matter of the exception and that he was afforded an opportunity to correct his errors. Rule 51 requires no more.

In *Williams* v. *Hennessey*, 328 F. 2d 490, 491, the Court of Appeals for the Fifth Circuit so held and stated:

> "Rule 51 does not require formality in making the objection and the form of the objection is not important as long as it is clear that the Trial Judge was informed as to the possible errors and was given an opportunity to correct them."

The statement of this Court in *Surowitz* v. *Hilton Hotels Corp.*, 383 U. S. 363, 15 L. Ed. 2d 807, 86 S. St. 845 (1966), is here applicable. In that case, the Court stated:

> "We cannot construe Rule 23 or any other one of the Federal Rules as compelling courts to summarily dismiss, without any answer or argument at

all, cases like this where grave charges of fraud are shown by the record to be based on reasonable beliefs growing out of careful investigation. The basic purpose of the Federal Rules is to administer justice through fair trials, not through summary dismissals as necessary as they may be on occasion. These rules were designed in large part to get away from some of the old procedural booby traps which common law pleaders could set to prevent unsophisticated litigations from ever having their day in court. If rules of procedure work as they should in an honest and fair judicial system they not only permit, but should as nearly as possible guarantee that bona fide complaints be carried to an adjudication on the merits. Rule 23(b), like the other civil rules was, written to further, not defeat, the ends of justice."

The purpose of the Federal Rules is circumvented and frustrated when grave charges of fraud such as here found by the jury are summarily dismissed without answer or argument. As stated in *Surowitz*, the rules of procedure should as nearly as possible guarantee that bona fide complaints be carried to adjudication on the merits, but the opposite is bound to follow when Appellate Court applies them in a narrow and highly technical manner. Under the circumstances of this case, the interpretation by the Court of Appeals literally creates the very procedural booby trap which gave this Court concern in that case and the construction in this instance should be rejected.

Going one step further and assuming, *arguendo*, that Petitioners failed to comply strictly with the requirements of Rule 51, the rulings of the District Court were so erroneous as to require invocation of the "plain error" rule. With that principle in mind, we point out that the rulings of the Trial Judge sharply contradict the teachings of this Court

and the pronouncements of other United States Courts of Appeals relative to the general thrust of federal securities laws. By way of illustration, the Court of Appeals for the Tenth Circuit itself does not subscribe to the substantive holding of the Trial Judge. (See the language of the Court in *Stevens* v. *Vowell*, cited and quoted hereinabove.)

From this holding alone, the manifest error of the Trial Judge becomes obvious and it is of broad and significant public interest. Particularly is this true in view of the jury finding of *intentional fraud* on the part of Respondent. Without doubt, the Court of Appeals should have reviewed and reversed under the authority of the so-called "plain error" rule. See *Atkinson* v. *Roth*, 297 F. 2d 570 (3rd Cir. 1962), *Sharp* v. *Root*, 240 F. 2d 519 (5th Cir. 1957); 5 Moore's Federal Practice, 1966 Supp. to Vol. 5, p. 167; *Ferrara* v. *Sheraton McAlpine Corp.*, 311 F. 2d 294 (2d Cir. 1962); *McNello* v. *John B. Kelly, Inc.*, 283 F. 2d 96 (3rd Cir. 1960); *Mazer* v. *Lipschutz*, 327 F. 2d 42 (3rd Cir. 1963); *Wirtz* v. *International Harvester Co.*, 331 F. 2d 462 (5th Cir. 1964).

POINT V.

THE COURT OF APPEALS ERRED IN RULING THAT THE STATUTE OF LIMITATIONS BARRED THE PETITIONERS' RIGHT TO RECOVER.

In holding that the Petitioners were barred by the Utah statute of limitations the Court of Appeals quoted a statement of the Trial Judge as follows:

> "* * * It is also agreed (and this may be implicit in the foregoing stipulation) the issue of the statute of limitations may be resolved by the

Court following the return of the special interrogatories.

> "While the parties generally feel that this involves solely or primarily an issue of law in view of the record, yet the parties understand and agree that the Court as fact finder may resolve any factual problems necessary to the resolution of the issue of the statute of limitations."

The only reference by the Trial Judge to the statute of limitations is this stipulation quoted in the opinion of the Court of Appeals. The jury was barred from consideration of all misrepresentations except one and the Trial Court made no findings of fact or conclusions of law relating to this issue or, indeed, any other point and this was because the jury's finding on reliance rendered wholly moot the issue of limitations. Accordingly, the crucial Findings of Fact were made, not by the Trial Court, but by the Court of Appeals.

The only conceivable ground upon which to support this usurpation of the fact finding power by the Court of Appeals is the last sentence of Rule 49(a):

> "* * * As to an issue omitted without such demand the court may make a finding; or, if it fails to do so, it shall be deemed to have made a finding in accord with the judgment on the special verdict."

It is submitted that the holding of the Court of Appeals cannot be supported by Rule 49(a) for the reasons that Petitioners demanded submission to the jury of this very issue of fact which the Court of Appeals resolved *by inference.* In that connection, it must be considered that the Trial Judge refused to permit the jury to consider any misrepresentations, other than those bearing on the value of

the stock. The Petitioners did not waive their claim based upon false statements or upon Respondent's overall scheme and they were not omitted by the Court for later consideration as he had previously held they were immaterial. This conclusion is fortified by the Judge's comment that the only issue remaining, i.e. limitations, was primarily an issue of law.

By its express terms, the permissible inference under Rule 49(a) comes into play only in cases where no demand has been made by a party for submisison of a particular issue to the jury. It has no valid applicability when issues have been withdrawn by the Court. If there was a waiver on an issue of fact, it was only as to whether the misrepresentation as to value was barred by limitations. In total disregard of that situation, the fact seized upon by the Court of Appeals to bar Petitioner's claims related to Vincent Chiodo's acquiring knowledge of the false representations that Respondent was not acquiring the stock for resale but that it intended to retain the telephone company as an operating unit. The Court of Appeals bottomed its finding upon a letter that Chiodo wrote in July of 1961; in holding that his claim and the claims of all Petitioners were barred by limitations the Court of Appeals does not explain how it bridged the gap from Vincent Chiodo to the other Petitioners or why knowledge of one misrepresentation would impart knowledge that the entire plan was fraudulent. Significantly, the Court of Appeals in its treatment of all issues, failed to give any consideration to the other persons who were injured and on this question, the disregard of their rights is most critical.

The misrepresentations by Respondent and knowledge of and reliance thereon by Petitioners were relevant to a

number of factual issues before the Trial Court, i.e., whether each representation was part of an overall scheme to defraud; whether it was a false statement knowingly made; whether it was causally connected with the sale of stock by Petitioners; and the date when its falsity became known to other Petitioners. These questions clearly were within the framework of the pleadings and the pre-trial order. Furthermore, Petitioners and Respondent specifically requested instructions designed for the resolution of these very questions by the Jury. Ironically and paradoxically, after the ruling of the Trial Judge that misrepresentation respecting Respondent's intention to retain the telephone company could not be considered by the jury in determining fraud on the part of Respondent, a letter from Chiodo, from which the Court of Appeals *inferred* knowledge respecting that intention was seized upon by the Court to bar Petitioners' claim under the Utah statute of limitations. Additionally, the Court of Appeals, in adding an inference upon an inference, found that the inferred knowledge of Vincent Chiodo was known to all other Petitioners and thus barred their recovery as well.

For the foregoing reasons, the erronous interpretation and application of Rule 49(a) by the Court of Appeals should be corrected. The principle announced has broad and devastating ramifications because of its applicability to all litigation in Federal Courts. The rulings of the Trial and Appellate Courts denied Petitioners their constitutional right of due process of law and a jury trial, contrary to the Fifth and Seventh Amendments to the Constitution of the United States.

CONCLUSIONS

It is respectfully concluded:

(a) That the issues herein involved pose important questions of federal law on the construction of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the United States Securities & Exchange Commission which should be, but have not been, resolved by this Court.

(b) That the Trial Judge incorrectly construed Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the United States Securities & Exchange Commission and unless the cause is reversed, the holding will seriously impair the possibility of enforcing Federal Securities laws through private actions.

(c) That the Trial Judge erred in limiting his instructions and special interrogatories to a single misrepresentation of value.

(d) That the Court of Appeals erred in its construction of Rule 49(a) and 51 of the Federal Rules of Civil Procedure, which unless reversed, will confuse trial and appellate procedure throughout the federal court system.

(e) That the Court of Appeals erred in announcing that there could be no fraudulent misrepresentation because the statements made to one Petitioner concerned a business purchase and were made to an insider which if permitted to stand as the law, will work to the advantage of persons promoting extensive illegal ventures and to the detriment of the public at large.

(f) That the judgment and decision of the Court of Appeals is in conflict with prior decisions of this Court.

(g) That the judgment and decision below is in conflict with decisions of the several Courts of Appeals.

For the above and foregoing reasons, it is submitted that the Petition for Certiorari should be granted.

Dated this 27th day of September, 1967.

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Keith E. Taylor
of and for
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APPENDIX A

TWENTY-NINTH DAY, MAY TERM,
MONDAY, JULY 3rd, 1967

Before Honorable Alfred P. Murrah, Chief Judge, and Honorable Delmas C. Hill and Honorable Oliver Seth, Circuit Judges

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Vincent Chiodo, et al.,
Appellants,

8876 vs.

General Waterworks Corporation, a corporation,
Appellee.

} Appeal from the United States District Court for the District of Utah.

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Utah and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby affirmed.

A true copy

Teste

WILLIAM L. WHITTAKER
Clerk, U. S. Court of
Appeals, Tenth Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

MAY TERM, 1967

VINCENT CHIODO, ETHEL CHIODO, L. J. CUMMINGS, RUSS WALDRON, LAREE M. CHIODO, GENE A. CHIODO, AMOS P. HANSEN, H. V. PECK, DON CHIODO, ERNEST G. EARL, RAYMOND HANSEN, WILLIAM PETERSON, MARY ANN NELSON and LOUISE HIGGINBOTHAM,

Appellant,

vs.

GENERAL WATERWORKS CORPORATION, a corporation,

Appellee.

Number 8876

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

Calvin A. Behle (Keith E. Taylor, Parson, Behle, Evans & Latimer, and Adam M. Duncan on the brief) for Appellants;

Peter W. Billings (Dale E. Anderson and Robert W. Edwards on the brief) for Appellee.

Before MURRAH, Chief Judge, and HILL and SETH, United States Circuit Judges.

HILL, Circuit Judge.

This case was tried to a jury and submitted upon special interrogatories under Rule 49(a). Judgment was entered upon the answers to the special interrogatories in favor of the appellee (defendant below) and the appeal is from that judgment.

Appellants, who were plaintiffs in the trial court, brought the action for rescission of a corporate stock transaction or in the alternative to recover damages by reason of the alleged violation by appellee-defendant of Securities and Exchange Commission Rule 10b-5 (Title 17, C. F. R. Section 240.10b-5) promulgated pursuant to 15 U. S. C. § 78j.

A detailed factual statement is necessary for an understanding and determination of the issues presented. On September 23, 1960, appellants Vincent Chiodo and his wife, Ethel Chiodo, who owned the controlling interest in the Bear River Telephone Company, a corporation, entered into an "Agreement and Plan of Reorganization" with appellee, General Waterworks Corporation. By the terms of this agreement, appellee agreed to deliver to the Chiodos 2.7 shares of its preferred stock in exchange for each share of Bear River common stock delivered to it by Chiodos. Under this agreement, on December 20, 1960, Chiodos delivered to General Waterworks 2481½ shares of Bear River stock and General Waterworks delivered the agreed number of shares of its preferred stock to Chiodos and other stockholders in Bear River.

Appellant Vincent Chiodo, in addition to being the largest stockholder in Bear River, had for many years prior to 1960 been the manager of the company. At the time he made the stock exchange agreement with General Water-

works, he procured a side agreement with the same company whereby he was to be retained for a period of ten years as manager of Bear River and his two sons were likewise to retain their employment with the new owners.

The events leading up to this agreement for exchange of stock are pertinent to the issues involved.

Appellant Chiodo acquired the controlling interest in the common stock of Bear River Telephone Company of Tremonton, Utah, in 1943, and at that time became manager of the telephone operation. In 1957, a missile manufacturing concern commenced operations in the area served by Bear River and a substantial expansion of telephone service in the area was necessitated. About this same time Chiodo began to have some thoughts about the sale of his company. In 1958 he asked Kander & Company of Washington, D. C., a firm that specialized in buying and selling telephone companies, to find him a buyer for his company. Lobred, who worked for Kander, procured an offer of $200,000.00 for the company in 1959 but Chiodo refused the offer. Lobred later visited Chiodo, looked over the Bear River Company and suggested an asking price of $250,000.00 for the company.[1] After his visit, Chiodo advised Lobred that he would like to make a stock trade with some company paying dividends. It was on this basis that Lobred approached appellee company in February, 1960, and some interest in the purchase was shown by an agent of General Waterworks. A meeting of the interested parties, including Lobred, was had in Chicago on May 4, 1960, in the office of appellee' attorney. A general discussion of

1. There is evidence in the record to show that on this occasion Chiodo, in effect, stated that he was willing to leave the asking price to Lobred.

the deal ensued and the meeting ended with an understanding that one Sanders, who had charge of appellee's telephone company's operations would personally inspect the Bear River property and Chiodo would be furnished detailed information about appellee company's various kinds of stock. The stock information was furnished by appellee for study by Chiodo and his attorney and Sanders inspected the Bear River properties.

The president of appellee company, Howard Butcher, called Chiodo on the telephone and discussed the making of a deal. A price of $250,000.00 for Bear River was discussed. Although the testimony about what was said at this time is conflicting, from all of the testimony it is apparent that this became an informally accepted price before the conversation was concluded, subject only to the working out of a plan for exchange of stock and taking care of some other details.

Thereafter, a satisfactory agreement was reached concerning the employment of Chiodo and his sons, approval of the sale was obtained from the Utah Public Service Commission and the transaction was closed in December, 1960.

In July, 1961, Chiodo and his sons, at a meeting in Denver with representatives of General Waterworks, were told of the possibility of a sale of the Bear River plant to Mountain States Telephone and Telegraph Company in which event Chiodo would be discharged from his employment. Chiodo began selling his General Waterworks stock soon after this meeting. The sale of Bear River to Mountain States did not materialize but a contract for the sale of the plant to another company was entered into by General Waterworks on October 19, 1964, and the sale was con-

summated in March, 1965. Chiodo had been discharged as manager of Bear River in December, 1963. He then brought suit in the Utah state court against the Bear River Company and General Waterworks and recovered a judgment in the amount of $81,264.99 under his separate employment contract.

Our first difficulty with this appeal is the sufficiency of proof to make a case. At the outset, all of the facts concerning the transaction between appellants and appellee leave us with grave doubts as to the applicability of Section 10b-5. This was something more than a corporate stock transaction, it was actually the sale of a business and the method used to convey control of the business was suggested by appellants because they derived a tax advantage therefrom and a fixed future income. During the period of time the negotiations between the parties were in progress and when the alleged false representations were made, the parties were not negotiating for the sale of corporate stock but rather for the purchase and sale of a going private business concern. We have doubt that either the Congress in enacting the Securities Exchange Act or the Securities Exchange Commission in promulgating Rule 240.10b-5 had any intention to include a business transaction such as we have here. However, we will not pursue this reasoning because there are other clear reasons why appellants cannot prevail.

Appellants, in their brief, present what they consider the broad issues of the case as follows:

1. Is common law type "reliance" a necessary element in a cause of action claimed to arise under the provisions of Rule 10b-5 duly promulgated in conformance with the

proviisons of Section 10(b) of the Securities Exchange Act of 1934?

2. If so, may the trial court condition recovery upon a specific and substantial "reliance" upon a single misrepresentation, which single misrepresentation is only one of many made in the furtherance of an over-all plan and scheme to purchase a security?

3. Were the appellants, under the facts here involved, entitled to maintain a claim for rescission?

The first two of these points, in effect, urge error by the trial judge in his instructions to the jury. These points can be cognizable here only if appellants, at the trial, complied with the clear mandate of Rule 51, F. R. Civ. P. This court has written many times concerning its interpretation of this rule.[2] The cases hold, in substance, that any objections to instructions must be made of record after the court has given his instructions to the jury and before the jury retires to deliberate upon the case; and that, in making such objections, the party objecting must state "distinctly

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2. Western Transmission Corp. v. Colorado Mainline, 10 Cir., No. 8717, ... F. 2d .....; Pool v. Leone, 10 Cir., 374 F. 2d 961; Hardware Mutual Insurance Co. v. Lukken, 10 Cir., 372 F. 2d 8; Dunn v. St. Louis-San Francisco Railway Co., 10 Cir., 370 F. 2d 681; Peter Kiewit Sons Co. v. Clayton, 10 Cir., 366 F. 2d 551; Locke v. Atchison, Topeka and Santa Fe Railway Co., 10 Cir., 309 F. 2d 311; Darter v. Greiner, 10 Cir., 301 F. 2d 772; Miller v. Brazel, 10 Cir., 300 F. 2d 283; Union Carbide and Carbon Corp. v. Nisely, 10 Cir., 300 F. 2d 561; Pridgin v. Wilkinson, 10 Cir., 296 F. 2d 74; Federated Mutual Imp. & H. Ins. Co. v. Fairfax Equip. Co., 10 Cir., 261 F. 2d 207; Pittman v. Harvey, 10 Cir., 261 F. 2d 44; Franklin v. Shelton, 10 Cir., 250 F. 2d 92, cert. denied, 355 U. S. 959; Western Machinery Co. v. Consolidated Uranium Mines, 10 Cir., 247 F. 2d 685; Hayes v. United States, 10 Cir., 238 F. 2d 318, cert. denied, 353 U. S. 983; Garden City Co. v. Bentrup, 10 Cir., 228 F. 2d 334; Solorio v. Atchison, Topeka and Santa Fe Railway Co., 10 Cir., 224 F. 2d 544; Jones v. KOMA, 10 Cir., 218 F. 2d 530; Chicago, Rock Island & Pacific Railway Company v. Kifer, 10 Cir., 216 F. 2d 753, cert. denied. 348 U. S. 917.

the matter to which he objects and the grounds of his objection."

We have painstakingly reviewed and considered the record before us on the sufficiency of appellants' objections to the court's instructions and they do not meet the requirements laid down by this court in the long line of decisions cited above. In a footnote we have set out verbatim the pertinent part of the colloquy between the court and cousel as shown by the record which occurred after the instructions here in question were given and prior to the time the jury retired to deliberate.[3]

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3. Following is the pertinent part of the colloquy between court and appellants' counsel about objections to instructions:

"MR. DUNCAN: The first interrogatory, we think it is error to say that the misrepresentation — that the value must have been substantially more than $250,000. If it were worth $260,000, for example, and the defendant knew it was worth $260,000 and knew it was going to be relied on, we don't feel it had to be substantially more.

"THE COURT: Oh, now, we went over these interrogatories in chambers hours ago. I invited any suggestion on the form. As I understand it, this form was approved without prejudice to your basic ideas. In the context of this case, if the jury finds the value was $260,000, they are not going to base a misrepresentation on that. And I'd set aside the verdict, anyway. You can note your exception, but I think that's nonsense.

"MR. DUNCAN: It was advanced in good faith, Your Honor.

"THE COURT: All right. I wish you'd advance those things on form when we've been laboring over these things since 11 o'clock.

"MR. DUNCAN: I think we had.

"THE COURT: It was not mentioned directly or indirectly.

"MR. TAYLOR: This goes to form. But it just dawned on me as the instructions were given — I guess it's Interrogatory No. 3, with respect to Vincent Chiodo — you said if you answer that no, then don't answer the rest. But a number of these other plaintiffs dealt directly. And I would think that conceivably some of them may have relied, even though the jury were to find that Vincent Chiodo because of the special relationship did not. And that would automatically preclude, for example, Ethel or LaRee or someone else who may have directly relied upon Sanders or Hansen from recovery.

This determination precludes appellants from raising here any question about the suffiicency of the court's in-

3. Continued.

"MR. DUNCAN: We did mention that this morning.

"THE COURT: Ethel? She said she relied on her husband. I think I'll stand on that.

"MR. DUNCAN: We asked about that this morning. And for the record — and it's difficult to identify by number — but the instructions with respect to proximately causing, without explaining that there may be several proximate causes. As to reliance, which I think was about 9, that the — the word 'primarily,' as we noted this morning, we felt was objectionable.

"THE COURT: Yes, you did note that this morning.

"MR. DUNCAN: And the item — Instruction No. 4, I think, of defendants, the Court gave in substance. And it related to the only fact you may consider error.

"We feel this was unduly restrictive and possibly —

"THE COURT: I see.

"MR. DUNCAN: We feel that this third interrogatory is the most important error, because the third interrogatory, the evidence shows that General Waterworks people talked to more than Vincent Chiodo; for example, his wife, his two sons, his two daughters-in-law. We asked about that this morning, Your Honor, and I thought the Court made that note —

"THE COURT: I thought this form was satisfactory. We did discuss the basic request about primary and substantial. And this ties in with that. I'm willing to stand on the defendant's request in that connection. And in that light my understanding was that this did reflect that basic request.

"* * *

"MR. DUNCAN: The only issue we feel is extremely vital in this reliance on Chiodo only, when there were statements made to other members of the family. And I think we've noted it, but not merely for the record.

"THE COURT: What about that — that there is some technical merit to the matter?

"MR. BILLINGS: You said in here —

"MR. TAYLOR: The interrogatory is all right. But it was the Court's instruction if they answered 3 negatively they didn't have to go on. I think the interrogatory is fine. It was the statement that if you answer 3 'no' you don't have to answer 4.

"MR. DUNCAN: If Chiodo didn't rely, then it's all over with.

"THE COURT: That's true."

structions or of the method used by the court to submit the case under Rule 49(a), F. R. Civ. P.[4] We are precluded from considering appellants' first two points.

Appellants urge error by the trial court in dismissing the first cause of action alleged in their amended complaint. This cause of action sought rescission of the entire transaction between appellants and appellee. The procedural history of the case is pertinent to a determination of this point. Appellants filed their first complaint on October 2, 1964, in which they sought only to recover damages from appellee. On October 28, appellee filed its motion to dismiss for failure to state a claim, for lack of jurisdiction and for lack of proper venue, which motion apparently was never heard by the court. On February 15, 1965, by leave of court, appellants filed an amended complaint setting out two causes of action, the first for rescission of the entire transaction and the second to recover damages because of fraud.

Appellee, on March 1, filed a motion to dismiss and strike the rescission cause of action for failure to join an indispensable party. In the motion it was alleged that General Waterworks had entered into a contract with Continental Independent Telephone Corporation whereby all of the stock in Bear River owned by appellant was to be transferred to Continental, thus, the court could not issue an

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4. Rule 49(a) provides in pertinent part:

"* * * The court shall give to the jury such explanation and instruction concerning the matter submitted as may be necessary to enable the jury to make its findings upon each issue. If in so doing the court omits any issue of fact raised by the pleadings or the evidence, each party waives his right to a trial by jury of the issue so omitted unless before the jury retires he demands its submission to the jury. As to an issue omitted without such demand the court may make a finding; or, if it fails to do so, it shall be deemed to have made a finding in accord with the judgment on the special verdict."

effective decree of rescission without having Continental as a party in the case. On March 5 appellants moved for injunctive relief to prevent the stock transfer from appellee to Continental. A hearing was held on this issue on March 9, injunctive relief was denied but appellee was granted leave to tender a proposed amended complaint joining Continental as a party defendant. On April 1 the court granted appellee's motion and struck all claims for rescission from the amended complaint. Appellants filed a second amended complaint on August 3, seeking damages only from appellee and the case proceeded to trial on this pleading.

The trial judge, in open court and upon the record, succinctly gave his reasons for sustaining appellee-defendant's motion to dismiss and strike the rescission cause of action from appellants-plaintiffs' first amended complaint.[5] The record shows that on October 19, 1964, and prior to any claim by appellants for rescission, General Waterworks en-

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5. "THE COURT: Well, as to all of the plaintiffs, the motion to dismiss and to strike is granted on the ground of the absence of an indispensable party; to wit, Continental. It is Continental, isn't it?

"MR. BILLINGS: Continental Independent Telephone Company, yes, sir.

"THE COURT: And as to Chiodo, the motion to dismiss the count or claim given to rescission is granted on the ground of election of remedies.

"I do that, mindful of the proposition that the doctrine of election of remedies is not favored in equity and should not be unduly extended, but upon the conviction that in harmony with the three or four cases going up to the circuit from this jurisdiction touching upon those rules, to wit, Estate Counseling Service v. Merrill Lynch, et cetera, 303 F. 2d 527, United States v. American Amalgamated Sugar Company, 48 F. 2d 156, which is a fringe case which holds that the mere filing of a suit in the law side, rather than the equity side, where there is no credit done with respect to election, and a case in which I went into the matter

tered into a contract agreeing to sell all of its stock in Bear River to Continental Independent Telephone Corporation and during March, 1965, had performed under this contract.

Judge Pickett, in Williams v. Pacific Royalty Co., 247 F. 2d 672, 675, speaking for this court defined an indispensable party "* * * to be one who not only has an interest in the subject matter of the litigation, but such an interest that a final decree cannot be made without affecting that interest * * *."[6]

The non-joinder of an indispensable party may, although it will not always, require a dismissal. Such party may be added if service of summons is possible and the joinder will not desroy the jurisdiction of the court.[7] The trial judge here admirably exercised judicial discretion, although he dismissed and struck the rescission cause of action, his order of March 9 granted appellants leave to file another amended complaint adding Continental as a party defendant to the rescission cause of action, but such an amended complaint was never filed. A second amended complaint was filed thereafter but rescission was not prayed for.

Without a doubt, Continental was an indispensable party to the rescission cause of action and the order of dis-

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5. Continued
and I think explored the limits of the doctrine of election, Morgan v. Hidden Splendor Mining Company, 155 F. Supp. 257, there is no question in my mind that here there would be an election of remedies as to Chiodo which would preclude him from obtaining rescission on the present state of the record."

6. See also other Tenth Circuit cases cited there and Thomas v. Colorado Trust Deeds Fund, 10 Cir., 366 F. 2d 140; Turner v. Brookshear, 10 Cir., 271 F. 2d 761; Reid v. Reid, 10 Cir., 269 F. 2d 923.

7. Vol. 3, Moore, F. P., 2907.

missal was good upon that legal basis. However, the trial judge, insofar as appellant Vincent Chiodo was concerned, further supported the dismissal upon the theory of election of remedies. Under the facts of this case we agree with the trial judge. In Estate Counseling Service v. Merrill Lynch, Pierce, Fenner & Smith, 303 F. 2d 527, under Utah law, we applied the doctrine of election of remedies and our decision there was a sound basis for the dismissal here.

One of the defenses raised in the trial court by appelle-defendant was the statute of limitations. Neither federal statute nor the rule under which the action is brought provides a period of time for the bringing of an action, therefore, we must look to the Utah statute of limitations respecting such actions.[8] Fraud actions, under the Utah statute, must be brought within three years from the date the fraud is discovered.[9] This action was commenced on October 2, 1964, which, under the clear and undisputed evidence in the record, was more than three years after Chiodo had knowledge of such facts concerning the alleged fraud as would put a person of ordinary intelligence and prudence on inquiry.[10]

In their brief, appellants summarize the alleged false representations relied upon as follows:

"a) Representations that $250,000.00 was a fair and adequate price for the Bear River Stock, and that a regu-

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8. International Union v. Hoosier Cardinal Corporation, 383 U. S. 696.

9. 78-12-26(3) Utah Code Annotated.

10. Horn v. Daniel, 10 Cir., 315 F. 2d 471; Gibson v. Jensen, 158 Pac. 426; Larsen v. Utah Loan and Trust Co., 65 Pac. 208.

larly traded and marketed, dividend-paying General Waterworks Company stock would be traded therefor."

"b) That appellee was not acquiring the Bear River Stock for resale but that it intended to retain Bear River as an operating unit."

"c) That Chiodo would be employed for a minimum period of ten years with broad managerial powers and assurance of continued employment for the two Chiodo boys."

Insofar as the first alleged act of fraud is concerned, little discussion is necessary. Vincent Chiodo, because of his close connection with the Bear River Company for a period of many years was in a better position than any other person to know the true value or worth of that property. It is difficult for us to see how *any outsider* even if he is possessed with knowledge of the company and its assets could mislead Chiodo about the worth of the company. Any such statement by an outsider to Chiodo could not rise to the height of a false representation, it could be nothing more than an expression of opinion. In any event, Chiodo had the opportunity to have full knowledge of the true value of Bear River stock and was in the best of positions for more than three years prior to the bringing of this suit to ascertain whether any statements made to him by another about Bear River were false.

In July, 1961, at the Denver meeting Chiodo learned that General Waterworks was negotiating for the sale of the Bear River plant and that, if the sale was made, he would be discharged as manager. Soon thereafter he began selling his stock in General Waterworks and on August 4, 1961, wrote a letter which plainly shows that he had knowledge of sufficient facts concerning the alleged acts of fraud

to put him or any other person of ordinary intelligence and prudence on inquiry.[8] [sic]

Appellant argues that the legal question of the application of the statute of limitations is not properly before us on this appeal. We do not agree. General Waterworks, by answer and by appropriate motions for a directed verdict at the close of plaintiff's evidence and after all of the evidence was in, preserved this legal question. As a part of agreement between the court and counsel concerning submission of the case to the jury upon special interrogatories and the disposition of remaining factual and legal questions the court stated as follows:

> "It is also agreed (and this may be implicit in the foregoing stipulation) the issue of the statute of limitations may be resolved by the Court following the return of the special interrogatories.
>
> "While the parties generally feel that this involves solely or primarily an issue of law in view of the record, yet the parties understand and agree that the Court as fact finder may resolve any factual problems necessary to the resolution of the issue of the statute of limitations."

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8. The letter in pertinent part is as follows:

"Mr. Sanders apparently has been in contact with A. T. & T. Company since the beginning of negotiations for his acquiring the common stock of Bear River Telephone Company from me on December 21, 1960.

"I want to assure you that this action comes as a complete surprise to me as well as our employees. All steps leading up to the acquisition were taken on the basis that General Waterworks would operate this property. I personally was assured that that would be the case. The price therefore was agreed at about a year's increase added to the surplus as of December 21.

"I am certain that Mr. Sanders entered into this agreement knowing that he was transferring the property to M. S. T. & T. Co. At the time he seemed very sincere in wanting to operate the property himself.

"It is clear that I have been used. * * *."

After the jury returned its answers to the interrogatories, appellee-defendant filed a motion for entry of judgment based on both the answers returned and the reserved issues of law. The court thereafter by "Judgment" specifically referred to the "motion for a directed verdict" and the answers to the interrogatories and proceeded to enter judgment in favor of the defendant and against the plaintiffs. From the wording of the judgment it is apparent that it was rendered on the basis of both the "motion for a directed verdict" and the answers to interrogatories. We consider the judgment, as rendered, to have sustained General Waterworks' contention as to the statute of limitations and agree with that disposition.

Other arguments are made here that we have not discussed but our disposition of the case makes such additional discussion unnecessary.

AFFIRMED.

APPENDIX C

STATEMENT OF BACKGROUND FACTS

1. The Parties:

Petitioner Vincent Chiodo, hereinafter called "Chiodo", immigrated to this country from Italy in 1914 at the age of 9 years (R. 1272). He has been engaged for his entire adult life in working for telephone companies (R. 1273-4). He was employed by Northwestern Bell in the engineering, construction and commercial department for approximately 18 years (R. 1273). In 1943, he acquired the controlling interest in the common stock of Bear River Telephone Company at Tremonton, Utah (R. 1273-4).

Bear River Telephone Company, hereinafter called "Bear River", is a public utility rendering telephone service in the northern part of Box Elder County, State of Utah (R. 1201). Chiodo acted as its General Manager and a member of its Board of Directors from 1943 until December, 1963. Petitioner Ethel Chiodo is the wife of Vincent Chiodo and Petitioners Gene and Don Chiodo are their sons. Both of the Chiodo sons were full-time employees of Bear River for some years prior to 1960 and continued in that capacity until 1964, at which time each of them was discharged by Bear River (R. 1202). Petitioner LaRee Chiodo is the wife of Gene Chiodo and was secretary of Bear River until 1961. Petitioner Mary Anne Nelson is a daughter of Vincent and Ethel Chiodo and was an employee of Bear River from some time prior to 1960 until 1963 (R. 1202).

Petitioner Russell B. Waldron was President and Director of Bear River, Ethel E. Chiodo served as Vice-President and Director, and Petitioners Amos P. Hansen and L. J.

Cummings served as members of the Board of Directors (R. 1202-3). Each of the other Petitioners was a resident of the State of Utah and the owner of shares of common stock of Bear River (R. 1201).

The Respondent is a corporation with its principal office at Philadelphia, Pennsylvania. It owns and operates various water utilities throughout the United States (R. 1203). In addition, some of Respondent's subsidiary corporations are engaged in industrial businesses (R. 1701-2). Respondent had 95 separate subsidiary corporations as of December 31, 1959, 110 separate subsidiary corporations as of July, 1965 and 130 to 150 subsidiary corporations at the date of trial (R. 1203, 1700).

Howard Butcher III, hereinafter called "Butcher", is the President and Chief Executive Officer of the Respondent and a Director of 30 to 40 different corporations outside of those affiliated directly with the Respondent. One of such directorships is the Pennsylvania Railroad in which he personally owns 60,000 shares of stock. He is the senior partner of Butcher & Sherrerd, a stock brokerage business with its principal office at Philadelphia, Pennsylvania and which is a member of the New York Stock Exchange and other stock exchanges, having been founded in January, 1910. Butcher was personally instrumental in organizing Respondent on July 1, 1942 with an initial investment of from $500 to $1,000 (R. 1204). Butcher at the trial characterized his "main occupation" as "stock broker" (R. 1695) and he claimed to have been a "salesman" for 43 years (R. 1711). Other representatives of Respondent who testified at the trial were John A. Gubanich, its Treasurer, James A. Jennings, its Secretary and General Counsel, Vance G.

Rigling, its executive vice President, and Al Weiskoff, its Assistant Secretary and Assistant Treasurer (R. 1204).

A. W. Sanders, hereinafter called "Sanders", was Vice President and General Manager of each of the telephone subsidiaries of the Respondent during the years 1959 and 1960. He became a Vice President of the Respondent in 1961. He died in 1963 (R. 1204).

Helmer Hansen, hereinafter called "Hansen", is an attorney at law of Chicago, Illinois who represented Respondent in the transactions here involved. Since 1925, he has practiced law, largely in the utility and corporate fields. His corporate work has concerned basically the organization of corporations and their financing. His utility work has included the acquisition and sale of utility properties and cost work relating thereto (R. 1204-5). Hansen was employed by A. W. Sanders in 1960 to represent Respondent in the acquisition of the capital stock of Bear River Telephone Company. He was not given specific instructions by Sanders as to his role in the transactions involved but he knew the functions expected of him because of the long relationship between himself and Sanders in dealing with acquisitions by Respondent (R. 1205).

Donald J. Bell is an attorney at law with offices in New London, Iowa. Prior to the death of Sanders, he was retained as general counsel by Iowa-Illinois Telephone Company. At the death of Sanders, Mr. Bell was employed as Vice-President and General Manager of each of the various telephone subsidiaries of the Respondent. In 1964 he became a Vice President of the Respondent in charge of its telephone subsidiaries (R. 1203-4).

2. Conditions of Sale of Bear River Telephone Company stock:

Bear River serves a rural, thickly populated, rich agricultural area in Northern Utah (R. 1332). In 1957, Thiokol Chemical Corporation commenced a missile manufacturing operation within the area served by Bear River (R. 1277-8). This required rapid and substantial expansion of service and created operating and financing problems (R. 1278-9, 1933). Although Bear River had "whipped" the resulting serious financial problems, it was not able to pay dividends (R. 1333). Appellant Vincent Chiodo, after 16 years of hard work in developing the Company, desired to begin to get some cash return out of the business (R. 1292-3), to have some free time for vacations (R. 1293) and to obtain technical and financial assistance (R. 1293). He, therefore, made preliminary inquiry to see if a sale or exchange of Bear River stock might be feasible (R. 1279, 2371). His initial contact was with Allen Kander & Company, a broker (R. 1279). The broker obtained an offer from Independent Telephone Corporation (R. 1284) which was rejected by Petitioners for the reason that Independent was not in a position financially to pay dividends on the Independent stock to be traded to Petitioners (R. 1288-9).

From the outset, any possible trade or sale, to be satisfactory to Petitioners, involved three general conditions:

a) A sale for a reasonable value, preferably through the acquisition of dividend-paying stocks by Petitioners in exchange for their own stock (R. 1292, 1329-30, 1333, 1570).

b) The acquisition by an operating, non-speculative company which would operate the facility as a going concern and not in turn just dispose of it by resale (R. 1384-6, 1569).

c) A ten year management contract to insure employment for Vincent Chiodo until retirement age, with broad managerial powers so that proper local management would be protected and continued employment for the two Chiodo boys would be guaranteed (R. 1294, 1307, 1334, 1569).

3. Representations made by Respondent to Petitioners in acquiring their Bear River stock:

Respondent learned of Bear River from James I. Lobred, representing Allen Kander & Company in February of 1960 (R. 1706). At that time, Respondent organized a plan for the acquisition of Bear River stock and authorized Sanders, Hansen and Butcher to acquire the same (R. 1706-8). The plan was implemented by a preliminary conference between Petitioners Vincent and Ethel Chiodo, Lobred, Hansen and Sanders in early May of 1960 (R. 1301-8) and by a personal telephone call from Butcher to Chiodo shortly after the preliminary conference (R. 1311-14). This was followed by exchange of correspondence and numerous personal meetings between the various Petitioners and Hansen and Sanders over approximately a six month period. In the course of the execution of Respondent's plan to acquire the Bear River stock, the conditions of sale set forth above were made known to Respondent, which in turn made numerous representations to Petitioners. Some of these representations are summarized as follows:

a) *Representations that* $250,000 *was a fair and adequate price for the Bear River stock, and that a regularly*

traded and marketed, dividend-paying General Waterworks Company stock would be traded therefor.

1) In the initial telephone conversation, Butcher represented to Chiodo that "he thought he would pay $250,000 but that was a lot more than the property was worth" (R. 1312). Chiodo asked why he was willing to offer more than the property was worth and suggested an appraisal. Butcher replied that "that wasn't necessary" (R. 1312). Butcher "highly recommended" an exchange of General Waterworks Company dividend-paying preferred stock which he represented "was widely held and had a wide market" (R. 1313).

2) On May 27, 1960 (R. 1326), Sanders stated several times to Vincent Chiodo and also to Ethel Chiodo that $250,000 was a "terrific lot of money for small telephone properties". Chiodo replied that he didn't want to "rob anybody" and suggested an appraisal. Sanders replied that "that would not be necessary" (R. 1329-30). In June of 1960 (R. 1346), Sanders told Chiodo and Gene Chiodo that "the $250,000 that General Waterworks was offering for the stock of Bear River Telephone Company was an exceedingly large amount; that General Waterworks was being very generous; that we (Petitioners) should have no hesitancy about accepting it" (R. 1349-50).

3) On August 3, 1960, Sanders, in the presence of Hansen, represented to Vincent Chiodo and to Ethel Chiodo at Tremonton that "this offer of General Waterworks of $250,000 for Bear River stock was a generous offer" (R. 1367) and Hansen represented to them at the same time in the presence of Sanders that

the "offer by General Waterworks for $250,000 for the stock of Bear River Telephone Company was a very generous offer" (R. 1367-8). Sanders represented on the same day to Chiodo and to Gene Chiodo that "General Waterworks was making us a very generous offer" (R. 1368).

4) On August 3, 1960 at a Board meeting of Bear River directors, Hansen represented to the Board that Petitioners "were getting a very fair price for the telephone company" (R. 1260), and Sanders represented that Petitioners were "getting a real good price" for their Bear River stock. Chiodo again suggested an appraisal and Sanders replied that "it wouldn't be necessary" (R. 1674). Sanders stated to Gene Chiodo that they were "getting much more than the stock was worth" (R. 1663).

b) *That Respondent was not acquiring the Bear River stock for resale but that it intended to retain Bear River as an operating unit.*

In the very first meeting between Chiodo, Ethel Chiodo, Hansen, Sanders and Lobred, Chiodo stated that he was interested in selling the Bear River stock only to "someone who was interested in buying telephone companies and not speculating" (R. 1569). Under date of August 23, 1960, Hansen wrote a letter to Chiodo (R. 1378-9) enclosing a Butcher & Sherrerd publication which contained the notation "Mr. Chiodo; Hot off the grill today. H. B. III" (R. 1380) which stated that General Waterworks Corporation had purchased properties for sums substantially under their depreciated original costs resulting in "so much gravy" to General (R. 1383-4). In a subsequent conversation

with Sanders, Chiodo advised him that it appeared that he, Sanders, had misrepresented to Chiodo that "General Waterworks is not selling properties" (R. 1380). He read the pamphlet to Sanders in September of 1960 and told him that "under no condition would I consent to a deal with General Waterworks if they had in mind a swap with some other company or if they had in mind the sale of this property or the purchase of this property from me for the express purpose of reselling it" (R. 1384-5). Sanders replied that the pamphlet refers to "buying and selling waterworks. It does not apply to telephones, to telephone properties" (R. 1385). Chiodo again reiterated to Sanders "if you have any intention whatever of trading this property to the Bell System or any other company, we are through talking right now" (R. 1385-6). Sanders replied that "they had no idea of buying Bear River Telephone Company as a speculative property, but they were buying it for the long pull and for an investment" (R. 1386).

c) *That Chiodo would be employed for a minimum period of ten years with broad managerial powers and assurance of continued employment for the two Chiodo boys.*

1) At the first meeting in Chicago in May of 1960, Chiodo advised Sanders and Hansen that he would expect a ten year management contract with continued employment for his sons (R. 1569). Chiodo there stated that Petitioners "would not consider any sale whatsoever unless a ten year employment contract was offered to me and my boys; that that would be a prerequisite to a sale" (R. 1307). Sanders agreed that Chiodo was "on the right track" (R. 1307). Ethel Chiodo repeated that Chiodo must have an employment

contract "as a prerequisite of any negotiations" and that "the boys had to be considered, as well". Sanders and Hansen "agreed that was the proper approach to the problem" (R. 1307-8).

2) In the telephone conversation between Butcher and Chiodo which followed, Butcher stated that he "wouldn't think of taking the property" unless Chiodo would manage it. Chiodo responded that the property wasn't for sale unless he could manage it (R. 1313-14).

3) Sanders wrote Chiodo on July 22, 1960 summarizing the managerial authority of Chiodo as contemplated in the employment contract (R. 1360-2). Upon receiving that letter, Chiodo told Sanders that he would not accept such conditions and that his authority must afford him "some where near" the managerial latitude that he "had as an owner" and that if this was not satisfactory with the Respondent "the deal was off". Sanders responded that Chiodo would be permitted so to manage and that he was willing to come to Tremonton to make a record of this agreement (R. 1363). On August 3, 1960, Sanders did come to Utah and certain of the discussions between Sanders and Chiodo were reported by a court reporter (R. 1367-9). At that time, Sanders stated to Chiodo that Chiodo was "to be the General Manager of Bear River Telephone Company" and that Respondent would permit him to "run the property" as he saw fit. Sanders also stated that in his opinion, the contemplated employment contract was "iron-bound" and that in his opinion and in the opinion of Hansen, Chiodo could not be fired during the ten year term of the contract (R. 1372).

4) At a Board of Directors meeting, Hansen stated that he was "happy to have retained the managership of Mr. Chiodo and his boys" (R. 1260). Sanders told Gene Chiodo that Respondent was "buying properties all the time", that he would have a chance for "openings later on" (R. 1662) and that Don and Gene Chiodo "certainly would have future prospects with the Company" (R. 1663). Sanders stated to Don Chiodo, "you are the type of person that we need in our plant for advancement in managementship. We're looking for people of your caliber all the time. We're buying properties, and we need people to fill these management positions" (R. 1668). Sanders told La Ree Chiodo that Respondent "needed men like the Chiodo boys to run our telephone companies" (R. 1674).

4. The General course of negotiations:

The bulk of the evidence offered at the trial concerned the negotiation of the employment agreement between Chiodo and Respondent and of a stock exchange agreement. This voluminous evidence will not be summarized in detail here. Suffice it to say that the Respondent aggresively pursued the consummation of an exchange agreement. As early as June 3, 1960 (R. 1980), Hansen had prepared a formal offer (R. 1980). By July 15 of 1960, Respondent had prepared and formally submitted to Petitioners an agreement already executed by Respondent with a request that the Petitioners execute the same and return it to Respondent (R. 1990, 1998, 2001).

On the contrary, the Petitioners proceeded cautiously. Ethel Chiodo advised at the initial meeting in Chicago that she wasn't interested in selling (R. 1569). Petitioners re-

peatedly threatened to break off negotiations completely when it appeared that one or more of the conditions set forth above might not be met (R. 1363, 1385, 1424). When it appeared that the Logan transcript (Ex. 20) was not going to be incorporated into the employment agreement, Petitioners by letter dated November 2, 1960 officially terminated negotiations (R. 1416-17). Each time that Petitioners made threats of terminating the negotiations, Respondent was quick to make representations which permitted negotiations to continue (R. 1363, 1385, 1424-5, 1416-18).

5. Acts of Respondent After the Exchange of Stock:

Despite the fact that Sanders during negotiations stated that Chiodo "has done a very wonderful job of managing the company since he purchased it", and "from all appearance and reports that I can get on him, I find him (Chiodo) to be an honest, sincere, hard working individual" (R. 1334), friction immediately developed relating to Chiodo's management. It became obvious that Chiodo was not going to be given broad managerial authority (R. 1449). Chiodo was discharged on December 6, 1963 (R. 1493). He maintained successfully in the State Courts an action for damages based upon breach of his employment contract (R. 1494). The discharge of Chiodo was followed by the discharge of Gene and Don Chiodo in 1964 (R. 1202).

Within three or four months after Respondent acquired the Bear River stock, it admittedly was contemplating its resale (R. 1488, 1725-6). By July of 1961, negotiations between Respondent and Mountain States Telephone and Telegraph Company for an exchange of Bear River stock became sufficiently concrete to advise employees of

the potential transfer and that employees, with the exception of Vincent Chiodo, would be retained in employment (R. 1352-4).

Respondent's total investment in Bear River stock is $250,000 (R. 1590-91, 1619) and it received from Bear River a $69,400 cash dividend prior to disposition of its Bear River stock (R. 1622, 1688). Despite this, its asking price was three to four million dollars (R. 1599) and the formula used to establish sales value was 25 times projected future annual income (R. 1680, 1719, 1794). Projected annual income as computed by Respondent itself was the sum of $156,553.65 (R. 1793-97). Butcher stated that Respondent had "no intention of weakening on our price" (R. 1723). In September of 1962, Sanders stated to Butcher that Respondent should not "consider any less than two million for our stock in Bear River" (R. 1724).

Respondent's continuing efforts to dispose of its Bear River stock resulted in its sale, together with the stock of the other telephone subsidiaries of Respondent, through contract executed in 1964. The price received by Respondent for the package of telephone companies was from 33 to 34 million dollars, approximately 25 million dollars over the cost to Respondent (R. 1603, 1626-8), and approximately 27 times consolidated annual earnings (R. 1766).

Since Respondent disposed of the Bear River stock as part of a package, direct evidence relating to the consideration received for the Bear River stock was not available. However, Bell testified that there are two primary ways of valuing telephone stock: A multiple of earnings (R. 1592-96) or a consideration of book value (R. 1620-21). Exhibit 131 (R. 1615) contains combined financial data of all of

the telephone subsidiaries and Exhibit 108 contains comparable finaniial records for Bear River Telephone Company alone (R. 1616). Pertinent pages of those exhibits were received in evidence as sub-exhibits 131a and 131b and sub-exhibits 108a and 108b (R. 1769). Armed with both the earnings of the package of telephone companies and of Bear River's portion thereof, the percentage of the 34 million dollars received attributable to Bear River easily can be computed (R. 1717-18, 1732-3, 1766). Similarly, if a comparison of book values were used, the other method suggested by Bell, the approximate value received for Bear River easily can be computed (R. 1732-3, 1766-7). In any event the use of either valuation formula demonstrates that Respondent in fact received the three to four million dollars consistently asked by it during negotiations for sale.

6. Intent of Respondent in Acquiring the Bear River Telephone Company Stock of Petitioners:

Pursuant to Special Interrogatory, the jury found that Respondent *"knowingly and with intent to deceive"* misrepresented the value of the Bear River Telephone Company stock to Petitioners (R. 1140). Although, the trial court would not permit the jury to consider evidence of misrepresentations by Respondent other than as to the value of the Bear River stock (R. 1141, 1933-4), that evidence would have supported findings that Respondent also knowingly and with intent to deceive misrepresented other material facts to Petitioners, and that all of such representations were part of an over-all plan, scheme, device and artifice to enable Respondent to acquire Petitioners' stock for a fraction of its value, and then to re-sell the same for a handsome profit.